NCUA News
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National Credit Union Administration

Johnson encourages safe, sound governance practices

NCUA Board Chairman JoAnn Johnson told credit union executives May 5, 2005, in Washington that all federal credit unions should consider guidance and periodically review policies and procedures related to corporate governance and auditing.

Addressing the Credit Union Executives Society's Public Policy Institute, Chairman Johnson said although the Sarbanes-Oxley Act does not apply specifically to federal credit unions, certain provisions may be appropriate for some credit unions to consider.

"As credit unions grow and diversify their operations, governance will continue to emerge as a significant issue for credit union board of directors and management," said Chairman Johnson. "It is vital that boards of directors are fully aware of their responsibilities, and likewise, management should maintain operating policies and practices that are fully in compliance with regulations and the Federal Credit Union Act.

"Credit unions should consider the Sarbanes-Oxley provisions that relate to accounting, auditor independence, corporate responsibility and enhanced financial disclosures," Johnson said. "It is not only about practices to comply with the law, but a continuous process to maintain consistent safety and soundness of the member-owned institutions."

She recommended credit unions review the agency's Letter to Credit Unions outlining selected provisions of the Sarbanes-Oxley Act of 2002 and related sound corporate governance practices for federal credit unions. The Letter to Credit Unions may be found at: http://www.ncua.gov/letters/2003/03-FCU-07.pdf. Also, the agency has a summary of selected provisions of the Act and related sound corporate governance practices for federal credit unions available at: http://www.ncua.gov/letters/2003/03-FCU-07Enclosure.pdf

***May 6, 2005** – Chairman JoAnn Johnson addresses the Credit Union Executives Society's Public Policy Institute in Washington, D.C.*

Rodney Hood nominated to NCUA's Board

President George W. Bush nominated Rodney E. Hood to a seat on the NCUA Board May 10, 2005. A native of North Carolina, Mr. Hood currently serves the President as associate administrator for Rural Housing Service at the U.S. Department of Agriculture. The Rural Housing Service is the largest direct lender of loans in the federal government.

"The President has made an outstanding selection in Rodney Hood for the NCUA Board," Chairman JoAnn Johnson said. "Rodney has a vast array of experience in financial services and affordable housing which will be an asset to NCUA and America's credit unions. Rodney understands the issues facing the nation's credit unions and the need for access to affordable financial services in communities across the country. I welcome the President's announcement and look forward to working with Rodney in the days ahead."

NCUA Board Nominee Rodney E. Hood

HIGHLIGHTS

Home equity lending guidance issued

NCUA and fellow financial regulators issued guidance in May to promote sound risk management practices for home equity lines of credit and loans. In some cases, credit risk management practices for home equity lending has not kept pace with the product's rapid growth and eased underwriting standards.

Along with vulnerability to interest rate increases, some of the risk factors causing concern are:

- Interest-only features that require no amortization of principal for a protracted period;
- Limited or no documentation of a borrower's assets, employment and income;
- Higher loan-to-value (LTV) and debt-to-income ratios;
- Lower credit risk scores for underwriting home equity loans;
- Greater use of automated valuation models and other collateral evaluation tools for the development of appraisals and evaluations; and
- An increased number of transactions generated through a loan broker or other third party.

The guidance is available on the NCUA website at: http://www.ncua.gov/letters/2005/CU/05-CU-07-encl.pdf

May 11, 2005, Alexandria, Va. – NCUA's Small Credit Union Working Group, established by Board Member Debbie Matz, receives an NCUA "Team of the Year Award" for proposing changes within the agency to help small credit unions grow and thrive. From the left are Nancy Padilla, Office of Small Credit Union Initiatives (OSCUI); Dan Gordon and Kim Iverson, Office of Capital Markets and Planning; Charles Brandon, OSCUI; Board Member Matz; John Dock and Carl Banks, OSCUI; Dave Shetler, Office of Corporate Credit Unions (OCCU); Working Group Chair Liz Whitehead, Region 1; Nick Sanimarco, OSCUI; Adrienne Munroe, OSCUI; and George Curtis, OCCU.

Johnson hails revised CURIA

House Financial Services Committee Members Ed Royce (R-Calif.) and Paul Kanjorski (D-Pa.) May 12, 2005, introduced a revised Credit Union Regulatory Improvements Act (CURIA) designed to overhaul regulations governing credit unions.

Originally issued in 2003, the comprehensive, revised CURIA bill contains numerous provisions including sections to ease restrictions on credit union member business loans, establish risk-based net worth standards for measuring credit unions' capital, and revise credit unions' minimum capital standards.

"The Credit Union Regulatory Improvement Act legislation introduced today by lead sponsors Representative Ed Royce and Representative Paul Kanjorski takes a significant step toward modernizing credit union regulation in an ever changing and dynamic financial marketplace, as well as providing meaningful improvements to America's credit unions' capital structure," Chairman JoAnn Johnson said.

"The new CURIA is greatly improved and builds upon recommendations made by many experts, including credit union regulators and executives," Royce said.

"Credit unions today are among the most highly regulated and restricted of all depository institutions. The new CURIA will ease these regulatory burdens responsibly and help credit unions to succeed in the 21st Century," Kanjorski added.

"I am pleased that NCUA's proposal for risk-based capital and reform for prompt corrective action, which is designed to strengthen safety and soundness, is an integral component in this legislation," Chairman Johnson noted. "A risk-based capital structure is the most comprehensive approach to improving the system for credit unions and is consistent with the standards established for FDIC-insured institutions.

"We value the congressional support for this legislation and look forward to working closely with Congress to help bring this important legislation to fruition," Johnson said.

NCUA News

National Credit Union Administration

NCUA News is published by the National Credit Union Administration, the federal agency which supervises and insures credit unions.

JoAnn Johnson, *Chairman*
Deborah Matz, *Board Member*

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Board actions May 19, 2005

Fidelity bond coverage changes proposed

The NCUA Board issued a proposal to amend Part 713, Fidelity Bond and Insurance Coverage for Federal Credit Unions, to increase the maximum allowable deductible for certain credit unions and to increase the required coverage amounts for both larger and smaller credit unions. The proposal is issued with a 60-day comment period.

The Board believes inflation and the substantial growth in credit union assets warrant these adjustments. Currently, the maximum deductible is $2,000 plus 1/1000 of total assets up to a maximum $200,000. The proposal recommends keeping the formula while raising the maximum deductible to $1 million for large, well-run credit unions that qualify under RegFlex. The proposed maximum $1 million deductible is reached when a qualifying credit union has assets over $998 million.

Since 1977, $5 million has been the maximum coverage required for a credit union with more than $295 million in assets. To address risk, the proposal would increase bond coverage at both ends of the asset range. For smaller credit unions, the Board proposes to increase minimum coverage to the lesser of $250,000 or total assets, and for credit unions with assets above $500 million, the minimum bond coverage must equal one percent of assets, rounded to the nearest $100 million, up to a maximum $9 million in coverage.

Bond forms approved

Approved bond forms and providers are listed on the NCUA website, which assures an accurate list is readily available. The proposal would eliminate duplicating this information in the rule. The proposal also seeks comment on whether to rescind approval of Blanket Bond Standard Form 23, unchanged since 1952 and believed to be obsolete. Finally, the proposal makes a technical change in Part 741 and seeks comment on additional factors for credit unions to consider when determining whether to secure bond coverage in excess of required minimums.

IRPS proposed on nondeposit investments

NCUA's Board issued a proposed Interpretive Ruling and Policy Statement (IRPS) to provide requirements and guidance for federally insured credit unions offering members nondeposit investments through third party brokerage accounts. The comment period is 60 days.

Replacing *Letter to Credit Unions No. 150* issued in 1993, the proposed IRPS reflects law and regulation changes affecting the sale of nondeposit investments, adds weight to the requirements and offers credit unions the opportunity to offer input.

The IRPS addresses SEC requirements and guidance as well as NCUA requirements and guidance. Among others things, it discusses the credit union/brokerage firm relationship and the responsibilities of each, the separation of investment sales from receipt of deposits or shares, contact with members concerning security sales, compensation and referral fees, the use of dual employees, sales to nonmembers and related issues.

Votes are unanimous unless indicated.

Johnson urges IT due diligence; compliance

Focus is information technology vendors and consumer compliance

America's credit unions should enhance due diligence of third party vendors and consumer compliance should be a top safety and soundness priority, Chairman JoAnn Johnson told the Information Technologies Credit Union Association in San Francisco May 13.

"Due diligence must remain a priority for credit unions," Chairman Johnson said, adding that NCUA is focusing on information technology and system controls in credit unions because safe integration of technology and proper data security for credit union members are important safety and soundness priorities.

"Just as modernizing technology is an important investment for credit unions, likewise, we at NCUA believe that maintaining modernization in our information systems is vital for the regulator and the regulated," said Chairman Johnson.

"However, there are data security threats occurring across the country and credit unions have been affected. Scams, such as phishing, have contributed to a rise in identify theft, credit card fraud and other Internet-based fraud. Therefore, these security threats must be considered as part of a credit union's information technology security plan."

In addition to technology issues, Chairman Johnson reiterated that violations of the Bank Secrecy Act (BSA) and Office of Foreign Assets Control (OFAC) regulations remain a focus and any violations will be addressed by NCUA.

The most frequently reported violations of the Bank Secrecy Act are weaknesses in member and/or customer identification policies, comprehensive anti-money laundering policies, and independent testing.

"NCUA takes BSA and OFAC violations seriously and encourages credit unions to have the appropriate compliance plans in place," reiterated Chairman Johnson. We also recognize as credit unions continue to modernize technology and implement compliance measures, it may require increased investments in fixed assets.

"While data security threats to credit unions have been limited compared to other financial institutions, we must not rest on our laurels, but should plan accordingly to meet the challenges ahead," Johnson said.

Who and What: Board Member Debbie Matz will participate in the D.C. Credit Union League's 71st Annual Meeting Reception.
When: Wednesday, June 1, 2005
Where: Holiday Inn on Capitol Hill, Washington, DC
Why: To discuss key regulatory issues and exchange ideas with credit union officials.
Contact: Patty Jenkins at 703-518-6318 or pjenkins@ncua.gov

Who and What: Chairman JoAnn Johnson will address the Women's Leadership Symposium.
When: Thursday, June 2, 2005
Where: Maui, Hawaii
Why: To provide an update on current issues and share insight into the future direction of American's credit unions.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Who and What: Chairman JoAnn Johnson will address the Big Ten Credit Union Conference.
When: Saturday, June 4, 2005
Where: Iowa City, Iowa
Why: To discuss regulatory issues.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Who and What: Board Member Debbie Matz will address the National Federation of Community Development Credit Unions' 31st Annual Meeting.
When: Thursday, June 9, 2005
Where: Sir Francis Drake Hotel, San Francisco, Calif.
Why: To focus on innovations to help small credit unions thrive and explain the resources available from NCUA's new Office of Small Credit Union Initiatives.
Contact: Patty Jenkins at 703-518-6318 or pjenkins@ncua.gov

Who and What: Board Member Debbie Matz will address the Mountain Regional Credit Union Roundtable co-hosted by the Wyoming, Idaho and Utah Credit Union Leagues.
When: June 14 & 15, 2005
Where: Snow King Resort, Jackson Hole, Wyo.
Why: To participate in the opening reception and present the keynote address.
Contact: Patty Jenkins at 703-518-6318 or pjenkins@ncua.gov

Who and What: Chairman JoAnn Johnson will address the Louisiana Credit Union League Annual Meeting and Convention.
When: Wednesday, June 22, 2005
Where: New Orleans, La.
Why: To discuss regulatory issues affecting credit unions.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Who and What: Chairman JoAnn Johnson will address the Access Across America Economic Empowerment Summit.
When: Tuesday, June 28, 2005
Where: Los Angeles, Calif.
Why: To discuss home ownership and economic empowerment initiatives.
Contact: Linda Queen at 703-518-6309 or lqueen@ncua.gov

Visit NCUA's website
www.ncua.gov
Credit unions can sign up for Express E-Subscription Service. Others can get the latest information by "RSS Feed" at
http://www.ncua.gov/RSS/NCUAChanges.xml.

Mark Your Calendar
June 28, 2005

Attend The Free
One Day Event

Economic Empowerment Summit scheduled in LA

NCUA is sponsoring an Access Across America Economic Empowerment Summit in Los Angeles Tuesday, June 28, 2005. Credit union officials and board volunteers in the western United States are invited to attend the free, one-day event focusing on federal resources available to enhance credit unions ability to expand financial services to their members by partnering with other federal agencies and non-profit organizations.

"NCUA is pleased to announce the third summit of 2005, which will bring together our public and private sector partners to discuss economic empowerment and financial self-sufficiency," said NCUA Chairman Johnson. "California credit unions have been instrumental in providing access to affordable financial services to the underserved and "unbanked" communities. We look forward to hosting this summit for credit union officials and volunteers in the western United States."

For more information or to register, please see NCUA's website at: www.ncua.gov or e-mail AccessAcrossAmerica@ncua.gov.

PALS panelists emphasize reaching new markets

280 from 35 states attend St. Louis workshop

Credit union leaders at Board Member Debbie Matz's 10th PALS workshop shared a wide variety of success stories proving that reaching new markets really is good business. In lively, interactive sessions, nine panelists and many of the nearly 280 credit union officials from 35 states discussed initiatives to reach "New Markets, New Members, and New Business."

"I hope all participants at our Spring PALS workshop were inspired to reach new markets where there are few other insured financial institutions – and tremendous business opportunities for credit unions," Matz emphasized. "Through the amazing innovations shared at this PALS workshop, credit unions have grown well beyond their traditional membership base. They are serving younger people, people of different ethnic groups, and people who had nowhere to turn but predatory lenders. These new members are generating new business which is really helping these credit unions thrive."

Vantage Credit Union (VCU) in Bridgeton, Mo., reached three non-traditional membership groups in one bold move – establishing a presence in underserved East St. Louis, Ill. The potential membership: 98 percent African American, with an average age of 31 and a median household income of $21,000. CEO Hubert Hoosman revealed that before making this move, "Some people asked, 'Why serve those people?' I asked, 'Why not?' Anybody can have a community charter. The challenge is to serve everyone in the community. If you're going to talk credit union philosophy, live it!"

Living this philosophy, in the past 15 months VCU has signed up nearly 1,000 new members and made nearly $4 million in loans in this underserved area. Astonishingly, these new members, who had few alternatives other than predatory lenders, are proving to be excellent credit risks. Delinquency at VCU's East St. Louis branch is only 0.28 percent – compared to 0.88 precent for VCU's membership at large. And while membership grows more ethnically diverse, it also becomes younger. In positioning VCU for the future, Hoosman explained, "We wanted to lower our members' average age, and we've done that – by nearly three years."

However, Hoosman reminded credit union colleagues that real-life success stories are not as simple as the movie fantasy "Field of Dreams." The movie's moral, "If you build it, they will come" does not apply to branching into new markets. Hoosman advised that before opening a branch and doing business, "you first have to be involved in the community."

Several panelists described how their community involvement has attracted new business from diverse groups of new members. Others described how they attract more members from within existing fields of membership and how hiring culturally diverse employees is a necessity in today's multicultural communities.

Presentations from PALS workshops are posted on the NCUA website. *Visit www.ncua.gov, click PALS then click Workshop Presentations.*

***April 28, 2005 St. Louis, Missouri** – Board Member Matz with co-hosts of the St. Louis PALS workshop. From the left are Kansas CU Association President Marla Marsh; National Federation of CDCUs Executive Director Cliff Rosenthal; Missouri CU Association President Rosie Holub; Debbie Matz; Iowa CU League President Tom Griffiths; and CUNA Senior VP Mary Dunn.*

PALS workshop July 7 in Baltimore

Eight credit union leaders will share winning strategies to "Knock Out Predatory Lenders and Improve Your Bottom Line" at the Summer PALS workshop for officials from large and small, federal and state, community-chartered and SEG-based credit unions hosted by Board Member Debbie Matz on July 7 in Baltimore.

The first panel, "Confronting Predatory Lenders Head-On," will feature credit union CEOs describing their efforts to compete with predatory lenders on their turf – communities where predatory lenders prey upon consumers with lower incomes and lower credit scores. The second panel will focus on "Beating Predatory Lenders at their Own Game," offering an opportunity to learn about credit unions' special loan programs, financial education, and other services to provide members with affordable alternatives to predatory lending.

View the agenda and register for the free workshop at: *http://www.ncua.gov. Click "PALS Workshop Registration, July 7, 2005."*

About Investments

New investment rate environment emerges

Since the start of 2004, the short end of the yield curve has risen 200 basis points, the result of Federal Reserve (Fed) rate hikes, while the 10-year Treasury bill has declined 15 basis points. The spread between long- and short-term rates has narrowed accordingly, producing a flattened yield or rate curve. The Fed perceives a need to restore naturally wider rate levels and repeatedly signals concerns about inflation in its public statements. Meanwhile, the bond market disagrees on inflation and recently has seen signs of economic softening which has taken further pressure off long-term rates.

In such an environment, credit unions would be prudent to consider targeting lower returns on assets to avoid excessive interest rate risk exposure, both in long-term real estate loans as well as long-term investments. With narrower spreads, net interest margins will shrink unless credit unions are willing to take on higher risks that may not be commensurate with returns. A disciplined investment strategy, perhaps laddering purchases out from three to five years, is the most likely means to safely manage for the future.

Long-term callable bonds present risk when it appears that long-term rates may have fallen close to the minimum. Collateralized mortgage obligations especially contain extension risk in support tranches that are structured to be particularly sensitive to rate changes when prepayments dramatically lengthen with relatively small rate increases. These "turbo" structures are designed to shift the extension risk out of shorter maturity PAC tranches. Credit unions should be careful to obtain the extension characteristics of any mortgage related security and ensure they are not left holding the riskiest segments.

Once, it was easy to assume that when the Fed decided the economy had gained the needed boost from a loose money policy and both long and short rates had renormalized, the world would return to a familiar environment where old strategies could once again be applied. Instead, credit unions have moved from being confronted by one set of complex risks created by excess liquidity to another set equally fraught with dynamic, inter-related risk based on yield-curve uncertainties. In such a setting, discipline, and a willingness to sacrifice some return, may well be the watchwords for some time to come.

May 4, 2005, Washington, D.C. –
Chairman JoAnn Johnson with Michael Hale, CEO of Andrews Federal Credit Union, at the grand opening of the Operation Hope Center in the Anacostia community of Washington.

The new Operation Hope Center will act as a catalyst in the community, connecting area residents seeking home mortgages or small business loans with area financial institutions that can provide access to capital, free financial seminars, ATMs, lending services, and electronic financial services.

Operation Hope is a national economic empowerment organization helping bring financial services and home ownership to underserved communities.

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